

Message Text

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PAGE 01 MOSCOW 19037 01 OF 02 270807Z

21

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FM AMEMBASSY MOSCOW

TO SECSTATE WASHDC 5701

LIMITED OFFICIAL USE SECTION 1 OF 2 MOSCOW 19037

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TAGS: EEWT EFIN US UR

SUBJECT: AFTER THE TRADE BILL: POSSIBLE TRADE MECHANISMS

1. SUMMARY: IN VIEW PASSAGE TRADE REFORM ACT, EMBASSY HAS BEEN CONSIDERING STEPS WHICH MIGHT BE TAKEN, EITHER BY SOVIETS OR BY U.S., OR BOTH, TO FACILITATE BILATERAL TRADE. WHILE THIS LEGISLATION MAY SERVE AS IMPETUS TO CONCLUSION OF NEW MAJOR CONTRACTS WITH U.S. FIRMS, IT WILL NOT, IN AND OF ITSELF, REMOVE TWO OF BASIC OBSTACLES TO EXECUTION OF THESE AND OTHER TRANSACTIONS: 1) POLITICAL/IDEOLOGICAL RIGIDITIES IN SOVIET SYSTEM WHICH PREVENT, AND WILL PREVENT FOR FORESEEABLE FUTURE EQUITY BY FOREIGN COMPANIES IN JOINT PROJECTS; AND 2) LIMITATIONS ON FINANCING AVAILABLE FOR PROJECTS IN USSR. THESE TWO PROBLEMS ARE, OF COURSE, LINKED IN THAT IMPOSSIBILITY OF EQUITY STAKE IN JOINT PROJECTS LIMITS AMOUNT OF FUNDS WHICH U.S. COMPANIES AND FINANCIAL INSTITUTIONS ARE PREPARED TO PUT OUT HERE AT LONG TERM. ONE STEP WHICH IN EMBASSY'S VIEW MIGHT SERVE TO ALLEVIATE THIS SITUATION IS ESTABLISHMENT OF ONE OR MORE "FREE PORTS" OR CUSTOMS ZONES ON SOVIET TERRITORY. EMBASSY SUGGESTS WASHINGTON CONSIDER THIS POSSIBILITY WITH AN EYE TO PUTTING IT FORWARD AT NEXT MEETING OF US-USSR JOINT COMMERCIAL COMMISSION. END SUMMARY

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PAGE 02 MOSCOW 19037 01 OF 02 270807Z

2. DEVELOPMENT OF BILATERAL TRADE AND ECONOMIC TIES OVER

LAST TWO YEARS HAS GIVEN RISE TO DISCUSSION OF VARIOUS FORMS OF ASSOCIATION BETWEEN AMERICAN FIRMS AND SOVIET ORGANIZATIONS. IN ADDITION TO A SERIES OF GOVERNMENTAL COMMISSIONS MEETING ALTERNATELY IN WASHINGTON AND MOSCOW, PAST EFFORTS TO BRING TOGETHER POTENTIAL BUYERS AND SELLERS FROM BOTH SIDES AND PROVIDE MEANS FOR THEM TO DEAL WITH EACH OTHER FREELY HAVE RESULTED IN EXPANDED GOVERNMENT COMMERCIAL FACILITIES IN EACH OF TWO CAPITALS, IN ESTABLISHMENT OF KAMA PURCHASING COMMISSION IN US AS SUPPLEMENT TO EFFORTS OF AMTORG, AND IN CREATION OF US-USSR TRADE AND ECONOMIC COUNCIL.

3. ON U.S. SIDE, GOVERNMENT EFFORTS HAVE CONCENTRATED ON BUILDING A USEABLE FRAMEWORK FOR TRANSACTIONS. THIS FRAMEWORK IS INTENDED TO FACILITATE COMMUNICATION AND MINIMIZE POSSIBILITIES FOR MISUNDERSTANDING ARISING FROM DIFFERENCES IN ECONOMIC STRUCTURE BETWEEN THE TWO COUNTRIES. ON SOVIET SIDE, SEVERAL INDUSTRIAL MINISTRIES (NOTABLY CHEMICAL INDUSTRY, PETROLEUM REFINING AND PETROCHEMICAL INDUSTRY, FOOD INDUSTRY, PETROLEUM INDUSTRY, AUTOMOBILE INDUSTRY, AND AVIATION INDUSTRY) HAVE CULTIVATED DIRECT TIES WITH AMERICAN INDUSTRIAL ENTERPRISES, SUPPLEMENTING AND IN SOME INSTANCES CIRCUMVENTING STANDARD AND CUMBERSOME SOVIET FOREIGN PURCHASE/SALE PROCEDURES CARRIED OUT THROUGH FOREIGN TRADING ORGANIZATIONS CONTROLLED BY FOREIGN TRADE MINISTRY. IN ADDITION, STATE COMMITTEE ON SCIENCE AND TECHNOLOGY (SCST) HAS ACTIVELY SOUGHT TO DRAW LEADING US FIRMS INTO "SCIENTIFIC/TECHNICAL COOPERATION AGREEMENTS" INTENDED TO PROMOTE AMERICAN PARTICIPATION IN SOVIET INDUSTRIAL PROJECTS AND TO IDENTIFY AND ACQUIRE ADVANCED TECHNOLOGICAL PROCESSES FOR USE BY SOVIET ORGANIZATIONS.

4. EXPECTING ROLE OF SCST, TO DATE TRANSACTION METHODS AND PROCEDURES REMAIN TRADITIONAL ONES, WITH FTOS AND US FIRMS NEGOTIATING FINAL CONTRACTS DIRECTLY. QUESTION OF FEASIBILITY OF BROADER "INDUSTRIAL COOPERATION" HAS ARISEN FROM BOTH SIDES AND HAS INCLUDED PROPOSALS THAT (1) ENTERPRISES OF ONE COUNTRY INVEST TECHNOLOGY AND EQUIPMENT IN PRODUCTION FACILITIES TO BE CONSTRUCTED IN LIMITED OFFICIAL USE

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PAGE 03 MOSCOW 19037 01 OF 02 270807Z

THE OTHER, LIQUIDATION OF THIS INVESTMENT TO TAKE THE FORM OF OUTPUT FROM THE NEWLY-BUILT FACILITIES (SO-CALLED "COMPENSATION PROJECTS"); (2) BOTH SIDES INVEST JOINTLY IN THIRD-COUNTRY FIRMS WHICH MIGHT OWN AND OPERATE PRODUCTION FACILITIES LOCATED IN EITHER OR BOTH OF THE PARENT FIRMS' COUNTRIES OR IN OTHER JURISDICTIONS; (3) IN CONJUNCTION WITH EITHER OF THE TWO PRECEDING ARRANGEMENTS, BOTH PARTIES INVEST JOINTLY OR INDIVIDUALLY IN TRADING COMPANIES

AUTHORIZED TO REPRESENT THE PRODUCT OF THE PARTNERS IN ONE OR BOTH PARENT COUNTRIES. ONLY THE FIRST OF THESE THREE POSSIBLE ARRANGEMENTS HAS BEEN REFLECTED IN ACTUAL TRANSACTIONS.

5. RELATIVE ADVANTAGES OF ONE OR ANOTHER OF THESE FORMS OF TRADING TIE DEPEND AS MUCH ON THE CHARACTERISTICS OF THE PRODUCTS INVOLVED AS ON SPECIFIC NATIONAL INTERESTS OR THE WISHES OF POTENTIAL PARTNERS. ADDITIONALLY, FREE CHOICE AMONG THE ALTERNATIVES IS LIMITED BY PROVISIONS OF DOMESTIC LEGISLATION IN EACH COUNTRY, NOT ONLY U.S. ANTI-TRUST LEGISLATION BUT ALSO SOVIET LEGAL REQUIREMENTS THAT MEANS OF PRODUCTION ARE PROPERTY OF THE STATE.

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PAGE 01 MOSCOW 19037 02 OF 02 270813Z

21

ACTION EUR-08

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LIMITED OFFICIAL USE SECTION 2 OF 2 MOSCOW 19037

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6. IN KEEPING WITH GENERAL EFFORTS TO SERVE AMERICAN BUSINESS, THE U.S. GOVERNMENT HAS AN INTEREST IN CONVINCING SOVIET AUTHORITIES TO ADAPT THEIR BUSINESS PROCEDURES TOWARD CONFORMITY WITH PRACTICES FAMILIAR TO AMERICAN FIRMS. APART FROM THE TACTICAL BENEFITS OF NEGOTIATING ON FAMILIAR TERMS, INDIVIDUAL FIRMS ACCUSTOMED TO A COMPETITIVE ENVIRONMENT MUST OVERCOME MAJOR STRUCTURAL DISADVANTAGES WHEN DEALING WITH THE STATE-TRAINING MONOPOLIES CHARACTERISTIC OF SOVIET AS WELL AS OTHER EASTERN EUROPEAN SOCIALIST SOCIETIES.

7. AS A SPECIFIC MEANS OF IMPROVING THE MOSCOW BUSINESS CLIMATE FOR AMERICAN ENTERPRISES, THE U.S. GOVERNMENT MAY

WANT TO ENCOURAGE THE SOVIETS TO ESTABLISH ONE OR MORE "FREE PORTS"--DESIGNATED GEOGRAPHIC ENCLAVES EXEMPT FROM CERTAIN PROVISIONS OF SOVIET LAW. WITHIN SUCH AN ENCLAVE, PRESUMABLY ADJACENT TO ONE OF THE INTERNATIONAL AIRPORTS OR THE PROJECTED INTERNATIONAL TRADE CENTER, CUSTOMS-FREE ENTRY OF MERCHANDISE MIGHT BE PERMITTED, INTERNATIONAL BANKS AND OTHER FINANCIAL INSTITUTIONS MIGHT BE AUTHORIZED TO CARRY OUT THE SAME ACTIVITIES AUTHORIZED BY THE LAWS OF THEIR PARENT COUNTRIES, AND JOINTLY OWNED AND OPERATED PRODUCTION FACILITIES AND FINANCIAL INSTITUTIONS MIGHT BE LOCATED. THE SOVIETS MAY SEE SUCH A FREE PORT AS ADVANTAGEOUS ALSO; IT MAY BE POSSIBLE TO ESTABLISH THERE SOVIET INSTITUTIONS WHICH COULD BE QUALIFIED AS INDEPENDENT BORROWERS BY LIMITED OFFICIAL USE

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PAGE 02 MOSCOW 19037 02 OF 02 270813Z

THE U.S. COMPTROLLER OF THE CURRENCY, WHICH COULD ALLEVIATE THE PROBLEMS POSED BY THE U.S. TEN PERCENT LENDING LIMITATION TO INDIVIDUAL CLIENTS.

8. IN CASE OF MAJOR PROJECTS PROPOSED FOR ENERGY/RAW MATERIAL SECTORS, A JOINT US-SOVIET COMPANY, OR COMPANIES, COULD BE FORMED IN "FREE PORT." OWNERSHIP OF JOINT COMPANY COULD BE DIVIDED 51 (SOVIET)-49 (AMERICAN) THUS ENSURING SOVIET CONTROL, AND FOR THAT MATTER "OWNERSHIP," OF ASSETS OF JOINT COMPANY. FACILITIES WITHIN USSR TO BE CONSTRUCTED WITHIN FRAMEWORK OF JOINT PROJECT WOULD BE VESTED IN JOINT COMPANY, WHILE U.S. INVESTMENT IN THIS PROJECT WOULD BE CONSIDERED ITS CONTRIBUTION TO ASSETS. JOINT COMPANY WOULD PERHAPS BE BETTER ABLE TO RAISE FUNDS ON INTERNATIONAL CAPITAL MARKETS, PARTICULARLY IF ITS OBLIGATIONS WERE UNCONDITIONALLY GUARANTEED BY SOVIET STATE AND U.S. CORPORATE PARENT, THAN WOULD EITHER U.S. PARENT OR SOVIETS SEPARATELY.

9. EMBASSY RECOGNIZES THAT THIS PROPOSAL WOULD RAISE SERIOUS IDEOLOGICAL PROBLEMS FOR SOVIETS. HOWEVER, IF WE WISH TO MOVE AHEAD NOW WITH SOME OF PROPOSED JOINT PROJECTS, SOME MEANS MUST BE FOUND TO MAKE INVESTMENTS IN USSR MORE ATTRACTIVE TO US FINANCIAL INSTITUTIONS. ASSUMING, AS EMBASSY BELIEVES IS THE CASE, THAT SOVIETS ARE AS INTERESTED AS WE ARE IN PROGRESS IN THIS AREA, THE TIME WOULD APPEAR RIPE TO BEGIN DIALOGUE WITH SOVIETS ON POSSIBLE SOLUTIONS, SUCH AS "FREE PORT" CONCEPT.

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